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March 11, 2004

VIA E-MAIL -- regs.comments@federalreserve.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulation CC; Docket No. R-1176

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)¹ is pleased to provide comments to the Federal Reserve Board (Board) on the proposed rule to amend Regulation CC and its commentary to implement the Check 21 Act.

ICBA Comments

ICBA applauds the Board for its expediency in issuing proposed regulations to implement the Check 21 Act. We believe that the Board has done an effective job of paralleling statutory requirements, clarifying appropriate provisions, and providing model notice language. We do have concerns about the potential unintended consequences of the complex MICR line creation and repair issues and we strongly encourage the Board to meet with industry representatives to further discuss these issues before finalizing the rule. We strongly applaud the Board's willingness to revise Regulation CC to include a new warranty relating to remotely created demand drafts.

In addition to ICBA's specific comments set forth below, ICBA has worked with other financial services organizations and associations to formulate a joint response. ICBA is pleased to join the signing organizations in recommending revisions that would:

¹ ICBA is the nation's leading voice for community banks and the only national trade association dedicated exclusively to protecting the interests of the community banking industry. ICBA has nearly 4,600 members with branches in more than 17,000 locations nationwide. Our members hold more than \$526 billion in insured deposits, \$728 billion in assets and more than \$405 billion in loans for consumers, small businesses, and farms. They employ more than 231,000 people in the communities they serve.

- Provide that a reconverting bank has an obligation to print the MICR information from the original check on a substitute check, except as provided under generally applicable industry standards;
- Allow a reconverting bank to repair the MICR line after the substitute check is created;
- Maintain the substitute check legal equivalent status if an inaccurate MICR line results from repair or creation;
- Extend UCC encoding warranties to substitute checks;
- Provide that a collecting or paying bank may, at its option, repair any portion of a MICR line on a substitute check and that such repairs would not implicate the Check 21 warranties;
- Seek clarification regarding the treatment of the unique codes in position 44 on the MICR line of the substitute check;
- Delete the proposed “Purported Substitute Check” provision;
- Create a new provision expressly authorizing a paying bank to create a legally equivalent substitute check without printing the MICR line information in MICR ink;
- Clarify that the term “check” in the Transfer and Consideration definition refers to the original check and any representation thereof;
- Clarify that the generally applicable industry standards identified in the commentary are an exclusive list of generally applicable industry standards;
- Allow for the alternative delivery of the consumer awareness notice at the time a bank provides a substitute check in response to a consumer check copy request;
- Not apply the duplicate payment warranty to a second debit that results from an ACH debit that is created with information from the original check or a substitute check;
- Significantly shorten the consumer education model notice;
- Include other model notices in the final rule; and,
- Remove provisions allowing a consumer to make an expedited recredit claim for a breach of UCC warranties with respect to a substitute check.

ICBA also supports the joint recommendation that the Board add a new Regulation CC warranty regarding demand drafts after soliciting comments on a specific proposal.

The ICBA’s comments on specific aspects of the proposed rule follow below.

Sufficient Copy and Copy – Section 229.2 (aaa)

To streamline the regulation and ensure consistency, the Board proposes to include terms “sufficient copy” and “copy” in Section 229.2 -- Definitions. The Board proposes to define a sufficient copy as “a copy of an original check that accurately represents all of the information on the front and back of that check as of the time it was truncated or that otherwise is sufficient to determine the validity of the relevant claim.” In addition, the Board proposes to define a copy as “a paper reproduction of an original check, including a paper printout of an electronic image of the original check, a photocopy of the original

check, or a substitute check.” The proposed commentary provides examples of what types of documents would constitute a sufficient copy and further clarifies that an electronic check image appearing on a computer screen, but not yet printed, does not constitute a copy or a sufficient copy. ICBA supports the inclusion of these terms in the regulation definitions and the commentary examples.

However, ICBA is concerned that the proposed definitions and commentary examples mandate a “paper only” environment by specifically excluding “an electronic check image appearing on a computer screen.” Under the proposal, banks would have to deliver a paper copy of the subject check to ensure compliance with the sufficient copy definition, depriving customers who have agreed to electronic communications of the opportunity to timely receive the copy and imposing unwarranted and additional expense on banks.

Given the pervasiveness of check imaging, online banking, and email technologies among community banks, ICBA is concerned that the proposed provisions, as drafted, would hamper community banks’ ability to use these technologies to deliver check images electronically. According to the 2003 ICBA/InFinet Community Bank Technology Survey, the majority of the respondents are using check imaging and online banking technologies, with a majority of the respondents either using or planning to evaluate email statement delivery.²

To address this concern, ICBA recommends that the Board modify the proposed definitions and commentary to permit the electronic delivery of a check image in response to a customer inquiry if the customer has agreed to accept the copy electronically. Such a change would be consistent with Section 229.58, which provides that bank may provide any information required by subpart D electronically if the customer has agreed. Moreover, it would provide community banks with the continued ability to use technology to flexibly and efficiently meet the needs of their customers.

Substitute Check General Provisions – Section 229.51(b)(1)

This proposed provision requires that substitute checks bear the indorsements of all parties previously handling the check in any form. This provision would be problematic for community banks using tabletop devices or other processing scenarios capturing check images before indorsements are applied, as indorsements would not appear in the image of the original check. Instead, indorsements would be printed or overlaid on the substitute check by the reconverting bank. ICBA encourages the Board to modify the commentary to acknowledge that indorsements applied after image capture would not appear in the image of the original check.

² The 2003 ICBA/InFinet Community Bank Technology Survey reveals that 53% of the respondents are currently using check-imaging applications and another 39% are planning to evaluate imaging applications within the next 12-18 months. Approximately 38% of the respondents allow customers to view imaged checks online. 11% of the respondents deliver email statements today, with an additional 52% planning to evaluate email statement delivery with in the next 12-18 months.

Form and Submission of Claim – Section 229.54(b)(3)

According to the proposed rule, if a bank requires a written expedited recredit claim, the time period a bank must act on an expedited claim starts on the banking day in which the consumer submits the written claim, including instances in which the consumer previously provided claim information in another form. ICBA supports this provision as it ensures consistency and fairness for all stakeholders.

The proposed commentary permits a bank two options for advising consumers of a written expedited recredit claim requirement: 1) including this requirement in the consumer awareness notice; and 2) informing the consumer at the time the consumer attempts to make an oral claim. While ICBA supports these options, ICBA recommends that the Board also afford banks the option of including this requirement in deposit account agreements or other disclosures such as monthly checking account statements.

Reversal of Recredit – Section 229.54(c)(4)

The Board is seeking comments as to whether a bank should be allowed to reverse any interest credited to the consumer once it determines that the consumer's claim is not valid and that a reversal of the recredit is warranted. Although the Check 21 Act is silent regarding the ability of banks to reverse any interest credits, ICBA believes that is reasonable for banks to have the ability to reverse interest payments as well.

Indorsement Standards – Appendix D

Appendix D currently permits depositary bank indorsements to be printed in dark purple or black ink and all other indorsements to be printed in a color other than purple. The Board proposes to amend Appendix D to require any indorsement, reconverting bank identification, or truncating bank identification on an original check or substitute check to be in black ink. ICBA supports this amendment, as the use of black ink will facilitate the reading of indorsements and identification numbers, particularly in an image-processing environment. Since the use of dark purple ink is currently permitted, ICBA recommends that the Board adopt a sunset date for the discontinuation of dark purple ink affording banks sufficient time to deplete existing dark purple ink supplies and to facilitate an orderly and cost-effective migration to black ink. We believe 12 –18 months from the date the regulations are final would provide sufficient time.

Expedited Recredit for Consumers – Commentary, Section 229.54

ICBA welcomes the proposed commentary provisions clarifying that a consumer receiving only a statement that contains an image of the substitute check and not the original substitute check cannot make an expedited recredit claim. ICBA believes that this clarification is consistent with the scope of Check 21.

Creation of a Substitute Check Without MICR Ink By Paying Bank

The ICBA encourages the Board to include a new provision that would allow a paying bank to create a legally equivalent substitute check without printing the MICR line information in MICR ink. Such a provision would allow paying banks in states requiring the return of cancelled checks to customers, the flexibility to deploy imaging technology for clearing and settlement while fulfilling state statutory requirements. In addition, the provision would provide banks the flexibility to continue to provide a legally equivalent substitute check to municipalities and other state governments that need paper without extending the expedited recredit warranties.

Conclusion

The ICBA strongly encourages the Board to adopt the ICBA and joint recommendations set forth above. We believe that these recommendations will further clarify the regulations and facilitate compliance and the use of the substitute check instrument to spur check truncation and more efficient check clearing processes.

Thank you for the opportunity to comment. If you have any questions or would like additional information, please contact Viveca Ware, ICBA's director of payment systems, at viveca.ware@icba.org or 202/659-8111, ext.2414. Thank you for your consideration.

Sincerely,

C. R. Cloutier
Chairman